We must ensure not to be caught unaware by the potential reach of the payday lending industry

blogs.lse.ac.uk/politicsandpolicy/payday-loans/

10/20/2014

*The payday loan industry is set to change dramatically. For one, new regulation that will set a limit on how much a payday lender can charge per loan will soon be unveiled. But an industry very often wedded to predatory practices will find ways to circumvent regulatory strictures. In this article, **Carl Packman** highlights the extent to which payday lenders internationally have been able to subtly run rings around the oversight of responsible lending.*

The payday loans industry has been on top of the news agenda again. We have recently found out that the UK's biggest payday lender, Wonga.com, had been in discussions with the regulator, the Financial Conduct Authority (FCA), to establish a debt write-off, affecting 330,000 of its customers, and a freeze on interest and charges for a further 46,000 other customers who with new rules on responsible lending would not have been given such an expensive form of credit.

In the same period Wonga.com had drawn a profit loss, going from a record high of £62.5 million in 2012, to a relatively modest though still enviable £39.7 million in 2013, while the Competition and Markets Authority (CMA) also announced it would bring greater transparency to the market by introducing a price comparison website to help consumers.

In short, while the industry will not become extinct in the UK, it will change rather dramatically – and for good reason. Before the creation of the FCA, the consumer credit market was regulated by the Office of Fair Trading. While strict rules and regulations about responsible lending practices existed in print, they were rarely put to use. Save for some 'mystery shopper' exercises and strong words in the media, the regulator simply did not have the adequate capacity to monitor the behaviour of a relatively small, but controversial new sector.

The FCA came in promising to show "teeth" with the industry, and regulate it properly. To a degree it has done this. A cap on the cost of credit, which for the first time will set a price limit on how much a payday lender can charge per loan, will be introduced and a good deal more oversight will occur – the upshot of which is that firms will have to abide more closely to the rules on responsible lending, which does mean a number of lenders will leave the market (playing by the rules is not quite so profitable). But if international evidence on payday lending is anything to go by, we know that industries such as payday lending that are very often wedded to predatory practices will find ways to circumvent regulatory strictures.

In my new book, *Payday Lending: Global Growth of the High Cost Credit Market*, I've highlighted what I call a lenders' strategic interaction with national policy. What I mean by this is the extent to which payday lenders internationally have been able to subtly run rings around the oversight of responsible lending. In Australia for instance, when only a few states and territories had interest caps of 48 per cent, lenders in Queensland and New South Wales avoided state regulation by including contractual terms to avoid the statutory definition of a credit contract and requiring borrowers to purchase additional goods as a precondition to obtaining a loan. These included the obligation to purchase "financial literacy" DVDs.

In the US, research by Brian Melzer found that the number of shop locations is almost 20 per cent higher in zip codes close to payday-prohibiting states. This suggests that lenders are opening shops on borders to serve borrowers in states where payday lending is prohibited. Further still, a significant proportion of online payday lenders in the US are partnering with tribes in order to benefit from tribal immunity, and in that way sidestepping existing state-level laws on lending. Closer to home in some EU states, notably Poland and the Netherlands, there have been instances of lenders who would adhere to interest rate caps but recoup "lost earnings" by charging substantial fees and additional charges.

To a degree all of the above, the UK included, have been caught unaware by the potential reach of the payday lending industry. It occupies a relatively small part of consumer finance, but contributes a large part of the financial harm felt by people who would be better served with a more responsible lender, like a community bank or a credit union. What the UK regulator must ensure is that we don't ignore the small gains of payday lending again, because extinction is not an option the industry will take lightly.

Note: This article gives the views of the author, and not the position of the British Politics and Policy blog, nor of the London School of Economics. Please read our comments policy before posting. Featured image credit: Ewan Munro CC BY-SA 2.0

About the Author

Carl Packman is an author and researcher in sub-prime finance and social exclusion. His second book, *Payday Lending: Global Growth of the High Cost Credit Market*, was published September 2014 by Palgrave Macmillan.